

Staff Report On Consolidation

March 29, 2005

Page 1

**(1) AB 1615 (Klehs)
SB 219 (Dutton)**

As Introduced February 22, 2005

As Introduced February 10, 2005

SUBJECT: Consolidate California's Revenue Agencies

SUMMARY AB 1615 (Klehs) and SB 219 (Dutton) are identical and discussed as one item below.

This bill would authorize the consolidation of four revenue agencies BOE, FTB, Employment Development Department (EDD), and the Department of Insurance (DOI). The consolidation would occur as of January 1, 2007, and provide that as of that date:

- All the duties, powers, purposes, responsibilities, and jurisdiction of FTB would be transferred to BOE.
- The executive officer of BOE would organize the new responsibilities in any manner deemed necessary for the proper conduct of the BOE's consolidated revenue collection, administration, and enforcement functions.
- FTB civil service staff would be transferred to BOE in accordance with current laws regarding civil service employees.

By June 30, 2006, BOE would be required to submit a report to the Governor and the Legislature regarding the plan for and the progress of the assumption of FTB's duties. The report would include recommendations for legislation necessary to achieve the efficiencies and purposes intended by this bill. These recommendations would include the following:

- A strategic plan regarding the assumption of FTB's duties, including the identification of critical issues such as the consolidation of computer systems, telecommunications, and office space.
- Identification of functions that would be conducive to consolidation or centralization such as administrative functions, document processing, remittance cashing, public service, collection, and physical equipment and facilities.
- Identification of administrative functions that cannot be readily consolidated due to statutory conflicts or inconsistent administrative processes.

This bill states legislative intent to provide a government organization that ensures centralized, effective, efficient, and impartial tax revenue collection, administration, and enforcement. In addition, the bill states intent to streamline the functions previously performed by both FTB and BOE and that this consolidation should occur 1) in the least disruptive manner so that tax collections are not adversely affected, and 2) as expeditiously as is feasible and economical.

This bill would be effective January 1, 2006.

Staff Report On Consolidation

March 29, 2005

Page 2

COMMENTS This bill would authorize the consolidation of the four revenue-generating organizations. The successor entity would have approximately 10,000 employees and an annual budget of approximately \$1 billion. The following table shows staff positions and funding based on the Governor's 2005/2006 proposed budget.

	Positions	Funding, in Millions
BOE	3,628.0	\$364.9
FTB	5,285.0	699.6 ¹
EDD	1,454.0 ²	pending
DOI	18.1	2.1

Until implementation plans and identification of problems are clarified, the impact of transfer of duties is unknown. Department staff notes the following concerns:

This bill would require BOE to report by June 30, 2006, on the plan and progress of BOE's assumption of FTB's, EDD's, and DOI's duties to be accomplished as of January 1, 2007. Actual consolidation then must be complete by January 1, 2007. If enacted, this bill would be effective January 1, 2006, and it may be difficult for BOE to submit the requisite report for consolidating the four departments by the June 30, 2006, deadline.

Pursuant to AB 986 (Horton, Stats. 2003, Ch. 569), the LAO recently issued a report to the Legislature regarding the merits of consolidating specific functions and operations of FTB, BOE, and EDD. LAO summarizes the findings of its report released January 10, 2005, as follows:

Consolidation of the tax agencies' payment and documentation processing activities could in the medium to long term generate some annual cost savings and interest earnings through elimination of duplicative functions and increased efficiencies. The state, however, would have to incur significant net costs in the short term to achieve these savings. In addition, such benefits are likely to be less than benefits from increasing electronic processing. We therefore recommend that low priority be given to consolidation of payment and document processing functions in favor of steps to increase electronic processing.

LAO further noted that expanding electronic technologies could be used to achieve "virtual consolidation" of remittance and document processing. The report states, "Under this type of system, taxpayers could log onto a single Web site and through a series of menus, be directed to the proper form which would allow them to file their taxes or remit a payment. This payment, in turn, would be automatically directed to the appropriate agency."

¹ This includes 142.8 positions and nearly \$237 million for the CCSAS Project.

² This figure is reflected in the 2003/2004 budget and does not include administrative support functions that are located in areas other than the Tax Branch, such as information technology, legal, information security, budgeting, personnel, and marketing.

Staff Report On Consolidation

March 29, 2005

Page 3

FISCAL IMPACT Consolidating FTB with BOE provides opportunities to increase efficiency and effectiveness over the long term; however, the magnitude of impact is unknown and would be realized over time. Potential benefits would be offset by the costs associated with merging the organizations and their systems, particularly in the short-term. The magnitude of the benefits and costs will depend on the degree to which the departments' programs and systems are integrated as a result of consolidation. In addition, working through the organizational, technology, and other issues associated with merging FTB, EDD, and DOI into BOE could divert resources from core revenue-generating functions and the California Child Support Automation System (CCSAS) Project, which must be successfully implemented to relieve the state of over \$200 million in federal penalties annually.

An accurate cost analysis of consolidation would require input from the other affected departments to analyze each function and process the department performs in comparison to functions and processes performed by BOE. Accordingly, the department's costs to administer this bill cannot be determined at this time. The department will continue to analyze consolidation and its potential fiscal impacts as this bill moves through the legislative process.

REVENUE IMPACT For the fiscal year 2003-04, FTB's programs contributed \$43.3 billion to the General Fund. This contribution represented 57.9% of General Fund revenues, which totaled \$74.8 billion. The timing of tax revenue receipts as well as disbursements to taxpayers would be impacted to the extent implementation of this bill disrupts FTB's existing programs

Pros:

- Because FTB and BOE have some similar functions, there could be opportunities to improve efficiencies in those areas, e.g., audit, collections, and administrative functions, such as personnel, procurement, accounting, budgeting, communication services, and other support function.
- While FTB and BOE currently share some information among their programs, bringing the information technology systems and data under one organization would provide opportunities for improving tax enforcement and customer service functions through better use of information. It could also alleviate some concerns raised by the IRS associated with sharing of IRS information across state entities.
- Each organization proposed for consolidation has experienced success in certain areas that could be leveraged by the programs of the other organizations. For example, it might be possible to expand FTB's Accounts Receivable Collection System and Integrated Nonfiler Compliance System to improve compliance in other tax programs.

Staff Report On Consolidation

March 29, 2005

Page 4

- A consolidated department would offer taxpayers and their representatives a single point of contact for filing of returns, payment transactions, inquiries for assistance, and other customer services.
- A consolidated department could further consolidate field office public service operations of the FTB and BOE.

Cons:

- BOE would be the administrator, auditor, and deciding body for taxpayer disputes of its actions. As a result, taxpayers could argue that they are being deprived of a pre-payment appeal to an independent administrative or judicial body. In most states and at the federal level, tax administration and tax adjudication functions are performed by independent bodies.
- Abolishing FTB would remove the Administration and its DOF from direct oversight of the administration of most state taxes. The majority of the state's revenue-generating functions would be under the direction and control of constitutionally elected officials. If this change were made, some taxpayers would likely still view the governor as accountable for tax administration despite the fact that the governor would have no direct involvement. In all but three other states, the governor has direct involvement in tax administration. At the federal level, the president is similarly involved in tax administration. Centralization of tax administration outside the executive branch was the primary reason cited by former Governor Wilson for his veto of AB 15 (Klehs, et. al., 1993/94).
- FTB, BOE, and EDD are each larger than most state revenue departments. The enormity of a consolidated department might itself increase the complexities of the administrative structure by adding more decision-making levels.
- Implementing a consolidation effort on the scale contemplated by this bill could, as a result of redirection of limited resources during the transition period, distract from the department's core revenue-generating programs and the CCSAS Project, which must be successfully implemented to relieve the state of over \$200 million in federal penalties annually.
- While consolidation would allow for unified administration for the tax agencies, the functional structure might not be much different than the current tax-by-tax structure. Since the four departments administer different taxes under distinctly different tax and compliance laws, it is unclear if there would be any economies of scale in combining similar staff functions. For example a consolidated audit division still may require specialization among auditors because: 1) the degree of complexity varies among the tax laws; 2) the tax calendars for income and sales and use taxes are generally different; and 3) the auditing requirements for one tax differ greatly from the other. A preliminary review of the organizational structure of other states

Staff Report On Consolidation

March 29, 2005

Page 5

indicate that within a general Department of Revenue some states¹ administer taxes as separate offices, divisions, or bureaus. This bill may result in an organizational structure similar to states with a common administrative oversight instead of actual consolidation of the agencies.

- There would be some costs associated with bringing the organizations together. The degree to which the departments are integrated will drive costs associated with integration, e.g., moving staff, training, and systems changes.

Status: AB 1615 (Klehs) Assembly Desk

SB 216 (Dutton) Senate Committee on Government Organization

(2) ACA 14 (DeVore)

As Introduced February 28, 2005

SUBJECT: BOE Renamed California Tax Commission/Expand Authority to Administer Income Taxes

SUMMARY This constitutional amendment would:

- Rename the BOE the California Tax Commission (CTC).
- Require the CTC to continue existing BOE duties and also to collect and administer income taxes imposed on persons, corporations, or other entities.
- Authorize the CTC to conduct administrative review of state tax matter determinations.

This measure would also make certain changes that would not impact the department. These changes would:

- Increase the number of voting members of the BOE/CTC from five to nine, including one governor appointee and three additional elected members.
- Limit to two terms any member appointed or elected on or after November 6, 2006.
- Direct the legislature to enact laws necessary to carry out provisions relating to establishment of the CTC, including laws necessary to establish new district boundaries.
- Make nonsubstantive technical changes.

This measure would become effective the day following approval by the voters in the first statewide election following approval of the measure by the Legislature.

COMMENTS The Revenue and Taxation Code requires FTB to administer and enforce the PITL and the CTL. It appears that the constitutional amendment generally would give some of these same responsibilities to the CTC, which could result in administrative conflicts between FTB and CTC since statutes establishing the duties of FTB would still exist. FTB may have to continue its statutory responsibility to administer

¹ Indiana, Kansas, Louisiana, Missouri, New York, and South Carolina.

Staff Report On Consolidation

March 29, 2005

Page 6

the income tax laws until terminated by enabling legislation or order of a state appellate court.

When providing for enabling legislation, consideration should be given to several non-tax responsibilities administered by FTB. These programs include: homeowners and renters assistance, political reform audit, nonadmitted insurance tax programs, and the CCSAS project. It is unclear whether it is the author's intent to shift responsibility for these programs to CTC or leave them with FTB.

ECONOMIC and FISCAL IMPACT This constitutional amendment should not affect departmental costs and tax revenue. The fiscal and economic impact, if any, would result from the ensuing enabling legislation.

Status: Assembly Desk

(3) SCA 9 (Ducheny)

As Introduced February 18, 2005

SUBJECT: BOE Renamed California Tax Commission/Administer Income Taxes

SUMMARY SCA 9 and ACA 14 discussed above are substantially the same except that SCA 9 also would make the CTC responsible for the collection and administration of any taxes that are withheld from wages (EDD's tax branch).

This measure would become effective the day following approval by the voters in the first general election following approval of the measure by the Legislature.

Status: Senate Revenue and Taxation Committee